

loan rangers

how architects are navigating today's precipitous lending landscape.

by cheryl weber, leed ap

■ If there was any doubt about the current hostile lending environment, consider an encounter New Jersey architect Gregory La Vardera had recently with a regional bank. Mere hours before his clients' construction loan settlement, the bank required his signature on an "assignment of architect's contract." In normal conditions, this is routine paperwork ensuring that, if the client defaults, the architect will service the project for the bank under the original contract terms.

Now, however, it included language pressuring La Vardera to give up basic rights. It stated, for example, that even before default, the bank would have to vet any contract changes. It also proposed that he would accept any third party to whom the bank assigned his contract, and that the bank would have full rights to use and reuse his design without additional compensation.

"It was perhaps the most outrageous contract request I've ever been presented with, and done in the context of, 'You'd better sign this or you're going to screw up your clients' settlement,'" La Vardera says.

It's just one example of the shenanigans banks



Aaron Thomas Roth

are pulling these days as clients, who are tentatively trickling back, try to get projects funded. Although architectural services skew to higher income brackets, most clients still depend on banks for financing. And banks, still stuck with toxic loans and taking the heat for the real estate bust, are making it difficult for even the most financially sound

clients to hire architects.

The assignment-of-contract glitch, though panic-inducing, is fairly easily resolved. A more systemic funding farce is low-ball appraisals. Almost everyone has stories of projects that shut down when appraisers failed to offer a value that made sense. More on that later. But suffice it to say that the road to housing recovery

will be long, thanks in part to dysfunctional lending practices. Like it or not, banks get to call the shots. Architects and their clients will have to be patient—and resourceful—because there is no quick fix.

onerous assignments

The assignment of ar-
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chitects' rights can surface at any time, even years after the original architect-owner contract is executed. Basically, it says that if party A goes under, party B takes over the contract to get the project done. Now, though, banks are trying to make changes in their favor. "They're often asking the architect to provide services beyond the normal scope, such as ensuring that all utilities are in place and permits are secured, which is the contractor's job," says Ken Wortley of Philadelphia-based Wortley/Poole Professionals, a risk manager and insurance broker for design professionals. "Banks literally see them as a wholesale opportunity to make changes to the agreement, or ignore it entirely and make their own provisions."

The situation is tricky because not only are architects exposing themselves to greater liability on the job, but they're also at risk for crashing the client's settlement. Wortley advised La Vardera to sign the bank contract but strike the offensive language and ask for payment of any outstanding fees the client owed. The settlement proceeded on schedule.

But there's more architects can do. Attorney Randy Koenig, FAIA, Koenig Jacobsen, Irvine, Calif., says he reviews at least one urgent assignment of architect's contract a month. "With stalled proj-

bypassing the bank

With low billings and tight credit a constant theme, Seattle architect Jerry Jutting recently found a way to generate some work while diversifying his retirement accounts. After identifying a need for young-adult co-housing in Seattle, Jutting and two partners built a single-family rental house targeted to recent college graduates. They found a small, inexpensive site close to a freeway and designed a house with six same-size bedrooms, each two sharing a bath.

But with banks unwilling to fund an odd-duck project, Jutting and partners financed the construction through an IRA. After setting up an LLC, each partner transferred \$130,000 from mutual-fund retirement accounts to a California institution specializing in self-directed IRAs. "It was important to have partners, so the other two could elect to hire me for the design work; I wasn't making the decision to pay myself," Jutting says. "The IRA trustee needs to make sure processes are in place so that any profit goes back to the IRA and people aren't skimming for their own use. The restrictions are the same as for a conventional IRA—we can't take profits until we retire."

Completed in September of this year, the rental will be managed through the LLC. For Jutting, it was a way to build a project with the potential for income and transfer some money away from the volatile stock market. "Now that it's built, the bank can see what it is, and they know what the income will be. We do have some banks interested in providing permanent financing now, and are hoping to do another project," he says.—c.w.

ects on the rise, lenders are placing more onus on these assignment of contracts," he says. "And the timing is interesting. It's always under drama because it must be done immediately. The architect gets severe pressure from the owner to accommodate, which can lead to a careless transfer."

His advice: Make sure an original owner-architect contract is in place before the client applies for a loan. Include an anti-assignment clause (legal leverage for

negotiation) stating that "the architect shall have no obligation to execute any documents or agree to any assignment of architect's rights or obligations after the execution of this agreement without the architect's express written consent."

A careful reading of the bank's contract can keep architects from undoing in one fell swoop what they've negotiated with the owner, Koenig says. Scope creep is the main red flag. When an

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owner defaults, banks expect the architect to protect their investment by overseeing construction, usually without compensation. Architects should demand payment for additional services, but limit their exposure. "The bank wants to obfuscate that separation between design and construction. We can't be responsible for construction errors, and we fight hard to promote that distinction," Koenig says.

When liabilities blur, the standard indemnity agreement also is in jeopardy. Koenig counsels architects never to "hold harmless" the lender or agree to pay

its legal fees if a dispute arises. "In my 25 years of practice, this has been the biggest legal issue affecting architects' businesses," he says. "I'd add a phrase—it won't be in there—stating that the architect's liability is limited to the amount of the fee or available insurance, whichever is less."

Koenig draws one more pre-emptive line in the sand: Architects must insist that all outstanding bills be paid before they start working for the lender. That's critical, he says, because banks like to insert that the lender won't be responsible to pay the architect's fees if the lender paid the owners for

"banks see assignment of contracts as a wholesale opportunity to make changes to the agreement, or ignore it entirely and make their own provisions."

—ken wortley

those fees. But that doesn't mean the owners paid the architect. And until they do, the bank doesn't have license to use the plans.

San Diego architect-developer Jonathan Segal, FAIA, takes self-protection a step further. His original contracts require a \$25,000 fee to change parties. "The assignment of contract is a horrible document," he

says. "I have had limited success striking clauses in loan documents."

numbers game

Horrible, perhaps, but it's a hitch many architects would welcome right now. It means they've landed a project, and it has appraised for enough money to obtain a loan. Memphis

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architect Todd Walker, FAIA, principal of Archimania, says low appraisals nixed three potential jobs in the past two years. One client, hoping to convert a warehouse to apartments, received an appraisal on the existing building 40 percent lower than its 1995 value. "It's disheartening," Walker says. "Generally appraisals are better with existing houses where people have equity."

It's the same in Minneapolis, where Sarah Nettleton, AIA, LEED AP, says clients recently tried to refinance a home she completed in 2007. They couldn't get comparables to

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—walter molony

support its value. Another client is awaiting word on a construction loan. "We're hearing they'll loan 80 percent based on appraisal, but this is a neighborhood of older custom homes," she says. "There are few comparables, and the underwriting has gotten stricter."

Restrictive lending has forced architects to shift their sales pitch. Pre-crash,

their first priority was to sell the design; now financials are front and center, perhaps rightly so. "I don't give them the full stream of, 'I can make this happen,'" Nettleton says. "It seems unfair for clients to pay tens of thousands of dollars for a piece of paper that's a dream, and then what? In the first meeting I try to filter out how

the money works. It adds a level of complexity to something that wasn't easy to begin with."

Further proof that low appraisals are weighing down the housing recovery, the National Association of Realtors (NAR) said that 16 percent of realtors surveyed reported a canceled contract in June of this year, and blamed the high number on low appraisals. In June 2010, only 9 percent reported a cancellation. Another NAR report found that 32 percent of members surveyed either negotiated a lower sales price or had a contract canceled or

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"It should be noted that appraisal-related cancellations generally result from banks requesting eight to 10 recent comps versus the traditional three, when there simply aren't that many apples-to-apples comps," says NAR public affairs officer Walter Molony. "For example, an appraiser may be forced to include trashed foreclosures in valuing a traditional home, so pressure from lenders is contributing to low appraisals and elevated cancellations."

Ken Chitester, communications director for the

National Appraisal Institute in Chicago, confirms that foreclosed properties may be used as comps. "In Las Vegas, if we eliminated foreclosures as comps, we wouldn't have any comps," he says. "The problem is that there are many inexperienced appraisers who don't know how to adjust the numbers properly when using them as comps."

Ditto that for adjustments in valuing one-of-a-kind properties. Declining appraisals go with a declining market. Yet the premium for quality architecture has never been well understood by most appraisers. "It's a mathematical flaw

to say you can't design the best or worst house in the neighborhood, that it always has to be somewhere in the middle," says Eric Rawlings, AIA, LEED AP, principal of Rawlings Design, Decatur, Ga.

As an example, Rawlings says a house he designed for a local speculative builder appraised for \$725,000, just \$25,000 more than a nearby cookie-cutter house 1,400 square feet smaller. As comps, the appraiser used two \$800,000 houses Rawlings also had designed. However, this house, too, eventually sold for \$800,000, and he

suspects the bank came up to the contract price after it was put on the market. "Value is such a fluid thing, that's why there's so much confusion," he says. "A lot of people assume appraisers have a magic methodology, but it's quite unremarkable when you look at it in more detail."

appraiser shopping

According to Chitester, the Dodd-Frank Act that was signed into law in July 2010 represented the largest overhaul of appraisal regulations since the savings and loan crisis of

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1989. Most of the changes, he says, have to do with appraiser independence to prevent banks from pressur-

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—sarah nettleton, aia, lead ap

ing them to hit a number. It also seeks to pay a reasonable fee to appraisers, since low wages and quick-turnaround jobs result in inexperienced people doing the bulk of work.

“Most appraisers say this is still not happening,” Chitester says. “Typically, banks hire an appraiser through an appraisal management company (AMC). The firewall put into place between appraisers and lenders exists, but the role of middleman may be played by a non-lending department in the same bank. Many of the largest AMCs are owned by the largest banks, and the best qualified appraisers typically aren’t the ones receiving assignments from AMCs.”

The only way around this flawed system, he says, is to ask the bank to assign the appraisal to the most experienced person they can find. (As backup, the Dodd-Frank bill explicitly states: “Persons who perform evaluations should possess the appropriate appraisal or collateral valuation education, expertise, and experience relevant to the type of property being valued.”) Usually that’s someone certified through a professional association. For example, the Appraisal Institute, which represents 25 percent of licensed appraisers, bestows MAI (commercial) and SRA (residential) certification on those who’ve attained a level of education, ethics training, and peer review beyond basic licensure. Banks might not honor the request, but you can ask for an appeal. Another option is to hire an appraiser directly and give the report to the bank, although the bank ultimately will hire its own.

Dave Porter, founder of PorterWorks, Stanwood, Wash., a former mortgage lender who provides training for builders, appraisers, and insurers, urges architects to get specific: Give appraisers a package outlining not just a house’s fine qualities, but how it’s different from the comps.

“What really frustrates me is the conversation about dollars per square foot,” Porter says. “A lot of builders are building

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cheaply to drive down the cost per square foot because appraisers continue to use it as a measuring stick. Conversely, during the market-driven bubble, people were paying \$800,000 for an 800-square-foot condo. There's a place in the valuation process for the cost-to-build approach, not just comp sales."

That idea resounds with Chitester, too. "Data is the lifeblood of the appraisal profession," he says. "The more they have, the more effective their analysis. There's a tremendous amount of education avail-

difference between an experienced and inexperienced appraiser is how they find the number and how well they can defend their work.

It's hard enough to establish a home's value once, let alone twice. With the economic outlook uncertain, San Diego's Segal is a proponent of construction-to-permanent loans, which roll the construction loan and mortgage into one. "It's a great way to do something if you have qualifications that you might not have next year," he says. "You're not doing appraisals and escrows and points twice, but the biggest thing is you don't have to qualify twice."

"with stalled projects on the rise, lenders are placing more onus on these assignments of contracts."

—randy koenig, faia

able—we have scores of courses and seminars. It's simply not the case that appraisers don't know the first thing about a good house."

The challenge is to find the right one. There's no cookbook for adjustments, but there are many ways to arrive at a credible opinion of value, Chitester says. The

Segal recently settled on such a loan for his own house, which he says appraised at \$4 million but will cost \$3 million to build. He paid a 1 point origination fee to lock in a 2.5 percent construction rate, changing to 4.3 percent when the building receives a certificate of occupancy. "It's unbelievable the amount of leverage you're getting versus a traditional loan, especially when the appraiser doesn't know what he's doing," Segal says, adding: "Money is cheap, and if you can get comps, now is the time to build. People need to understand that building a house is a business, and make sure it's solvent. Architects can take a more active role in the business world and solicit the banks for clients." **ra**